Sahara Energy Ltd.

2005 Annual Report

SAHARA ENERGY LTD. – REPORT FOR THE INITIAL PERIOD FROM NOVEMBER 18, 2005 TO DECEMBER 31, 2005

REPORT TO THE SHAREHOLDERS OF SAHARA ENERGY BY THE PRESIDENT

Highlights

- **Commenced operations as Sahara Energy Ltd. on November 18, 2005.**
- **Completed financings to raise initial capital of $3,686,064.**
- **Drilled 11 (3.5 net) wells.**
- **At December 31, 2005, 10,616,000 common shares were issued and outstanding.**

Overall Review

We are pleased to report operating results for the initial period from November 18, 2005 to December 31, 2005. The Company commenced operations in mid November, 2005, thus this reporting period is for a six-week period only. During this period, the Company drilled and cased 11 wells. Of those wells, 8 are located in the Lashburn area of western Saskatchewan and resulted in 8 oil wells. In Alberta, the Company drilled 3 wells resulting in 2 gas wells and 1 standing cased well. Subsequent to year end, we have been extremely busy securing land through farmins and acquisitions arrangements with industry partners. This has resulted in Sahara securing 57 drilling locations and 6 of these wells have been drilled in early 2006 resulting in 4 gas wells and 2 oil wells. The Company has an additional 51 wells to drill in 2006 with an average working interest of 40%. Currently Sahara's production is 80 BOEPD with 75 BOEPD behind pipe. awaiting tie-ins and completions. We have identified these 51 drilling locations through seismic and acquired surface leases on the majority of those locations. To date, Sahara has been successful in obtaining equipment and getting wells drilled and completed during a very busy industry period where services have been difficult to obtain. With our qualified technical team, we feel confident that we will be successful in drilling the remaining 51 locations prior to December, 2006. This will bring our total well count for 2006 to 68 wells with an average working interest of 40%. We are constantly evaluating and securing additional drilling locations that will add to this total. For instance, we have recently committed to drill 2 gas well locations in southern Alberta participating for a 75% working interest and 1 dual oil/gas test well in Saskatchewan for a 75% working interest and 3 oil locations in central Alberta for a 50% working interest. Sahara has also frozen up to15 sections of mineral rights under the TLE program with our joint venture partner (the Mosquito First Nations Band) in western Saskatchewan. We believe that our land strategy is proving successful and we will continue to focus on this strategy to build shareholder value.

Operations Review for 2005

Western Saskatchewan

Buzzard Area: Sahara has drilled 2 wells both at 33.3% BPO and 20% APO. Both wells have been completed in the Lloydminster sand for a combined initial production rate of 50 BOEPD (16.7 BOEPD net to Sahara). These wells have set up numerous offset oil locations.

Lashburn Area: Sahara has drilled 4 wells all at 33.3% BPO and 20%APO. One well (4-3) has been completed in the Lloydminster sand for a gross IP of 34 bopd (11.2 bopd net to Sahara). A second oil well (1-4) has been completed in the Sparky sand for a gross IP of 14.5 bopd (4.8 bopd net). Two other wells (10-2 and 3-3) have been completed in the Colony gas zone, testing is complete and the wells are currently waiting on pooling and tie in. Both of these wells have oil zones in them that will be completed or re-drilled in the near future. These wells have set up further development drilling locations on the lands.

Maidstone Area: Sahara has drilled 3 wells both at 33.3% BPO and 20%APO. The 9-12 well has been initially completed in the Colony gas zone but testing has resulted in a limited size reservoir. Plans are in place to recomplete the well into the Lloydminster sand as an oil producer. A second well (6-21) has been drilled and completed as a Sparky oil well with a gross IP of 44 BOEPD (14.7 BOEPD net to Sahara). A third well (5-29) has been completed in the Sparky zone for a gross IP of 43.3 bopd (14.4 bopd net to Sahara). Further development drilling locations will be drilled on these lands will be drilled in the near future.

Alberta

Lloydminster Area:: Sahara owns 5 drillable prospects that are highly prospective for General Petroleums (GP) and Sparky sands in Township 49 and 50 Range 1 W4M. Pending success of these five new wells, an additional 4 to 6 drilling locations will be firmed up. These lands are capable of economic quantities of heavy oil 12-15 API). The locations are well defined by offsetting production and old abandoned wells that indicate by-passed pay. Anticipated production for the wells is expected to be an IP of 50 to 70 BOEPD and a stabilized rate of 25 bbls/day per drilled well. Reserves from the Sparky/GP zones wells in the area are from 40 Mbbls to as much as 108 Mbbls per DSU. Sahara will own all rights (100%) in a net 600 acres from surface to the base of the Mannville. Drilling spacing in the area is 20 acres per well. There is one well, currently shut-in due to wet lease conditions, which will be placed back on production at 10 bbls/day. Total stabilized production from the 5 new drills is expected to be approximately 125 BOEPD.

Wood River Area:: Sahara has drilled one well at 25% BPO and 12.5%APO. The well has been completed and tested in the Ellerslie gas formation. This well is currently waiting on tie in. Another development gas well location may be drilled on these lands.

Lethbridge Area:: Sahara has drilled one well at 37.5 % working interest. This well is standing cased and our technical staff is currently reviewing follow up potential.

Decrene Area: Sahara re-entered and completed one well at 15% working interest. This well tested Belly River gas but fracture stimulation resulted in and uneconomic well due to significant water inflow. Our partners are evaluating redrilling this location.

Sahara has also secured drilling locations at Lashburn, Maidstone, Buzzard, Dee Valley and Soda Lake areas of western Saskatchewan. Sahara has also secured drilling locations at Lloydminster, Little Bow, Oyen, Czar, Malmo, Pembina, Round Hills, Norris, Spruce Grove and Westlock areas of southern and central Alberta. We also have locations in the Tangent and Gold Creek areas of northern Alberta. Seismic has been evaluated, surface leases are being acquired and we are confident that the 57 well locations (25 net wells) will be drilled and evaluated prior to December, 2006.

Sahara has assembled a strong management team with the technical experience and deal-making abilities to grow our Company. This is evident by the number of drilling prospects that we have put together in the short five month period of Sahara's existence. With an experienced Board of Directors and a strong shareholder base, management of Sahara is committed to the future growth of our Company.

On behalf of the Board of Directors
Peter J. Boswell
President and CEO
May 7, 2006

SAHARA ENERGY LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS
2005 ANNUAL

The following discussion and analysis is from the commencement of operations of the amalgamated corporation, Sahara Energy Ltd., ("Sahara" or the "Company") for the period commencing on the date of amalgamation, November 18, 2005 to December 31, 2005.

Introduction

The discussion and analysis of the operating results and financial position of the Company should be read in conjunction with the Financial Statements of the Company and related Notes (the "Financial Statements"), which have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) (see Summary of Significant Accounting Policies and Note 1: Nature of Operations).

The Company was incorporated under the *Business Corporations Act* (Alberta) on January 5, 2005 as Battleford Capital Inc. ("Battleford") as a capital pool company subject to the successful completion of its qualifying transaction. Battleford completed its qualifying transaction on November 18, 2005 when it amalgamated with Captain Energy Inc., a private oil and natural gas company based in Calgary, Alberta. The name of the amalgamated corporation was changed to Sahara Energy Ltd. . Sahara was approved by the TSX Venture Exchange to continue business as a newly formed junior oil and gas company and focuses on the acquisition, exploration, exploitation and development of oil and natural gas in western Canada. Sahara Energy's areas of focus are Lloydminister, Alberta, Western Saskatchewan, Central Alberta, and Southern Alberta. Sahara plans on growing via the drill bit utilizing a farmout and land acquisition strategy.

Net Loss

As at December 31, 2005, the Company was still in the exploration stage of production and had no production revenues and no depletion had been taken. The Company had a net loss of $358,308 or $0.09 per share with a weighted average number of common shares outstanding of 3,826,170. The Company's net loss is affected by items which are non-operational in nature. At December 31, 2005 these non-cash items included stock based compensation expense of $237,814 and depreciation expense of $3000 resulting in an adjusted net loss from operations at December 31, 2005 of $117,494.

Liquidity and Capital Resources

The Company had a cash balance of $2,045,000 and working capital of $1,915,099 as at December 31, 2005. The Company has sufficient working capital to meet all commitments to which it is currently committed.

Through a private placement, the Company issued 6,116,000 Flow-Through common shares at $0.50 per share and received $3,058,000 in gross proceeds. For each share issued a one-half of one common share purchase warrants were issued totaling 3,058,000 warrants exercisable at $0.75. As at December 31, 2006, 100,000 warrants had been exercised for total proceeds of $75,000.

Investing Activities

To December 31, 2006, the Company spent $1,843,481 on petroleum and natural gas assets.

Critical Accounting Estimates

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company.

Full Costing

The Company follows the full-cost method of accounting for oil and natural gas properties, whereby all costs associated with the exploration for, and the development of, petroleum and natural gas reserves, whether productive or unproductive, are capitalized in cost centers. Capitalized costs include land acquisitions costs, geological and geophysical expenditures, rentals on undeveloped properties and drilling and overhead expenses related to exploration and development activities. Proceeds from disposition of property are credited to the net book value of the property and equipment. Gains and losses are not recognized upon disposition of oil and gas properties, unless the disposition would significantly alter the rate of depletion.

Capitalized costs are depleted and amortized using the unit-of-production method based on gross proved oil and gas reserves as determined by independent engineers. For purposes of the depletion calculation, proved oil and gas reserves are converted to a common unit of measure on the basis of the relative energy content of 6,000 cubic feet of natural gas per barrel of oil.

In applying the full cost method, the Company calculates a ceiling test for each cost centre whereby the carrying value of property and equipment is compared at each reporting period to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are

estimated using third party quoted forward prices, adjusted for transportation and quality, less estimated costs directly associated with the development, production and sale of reserves. Should the ceiling test result in an excess carrying value, the Company would then measure the amount of impairment for the cost centre by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as a permanent impairment.

Stock-based Compensation

The Company uses the fair value method of accounting for options granted to employees and consultants. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model and charged to earnings over the vesting period with a corresponding increase in contributed surplus. Upon the exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk, which even with a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on future exploration by Sahara will result in new discoveries of oil and natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones, tools lost in the hole and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The long-term commercial success of Sahara depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that Sahara will be able to continue to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participation are identified, Sahara may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic. Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recover of drilling, completion and operating cost. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to

maximizing production rate over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blowouts, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Sahara Energy Ltd.
(An Exploration Stage Company)

Financial Statements

Period Ended December 31, 2005

CHARTERED ACCOUNTANTS

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Auditors' Report

To the Shareholders of Sahara Energy Ltd:

We have audited the balance sheet of Sahara Energy Ltd. (formerly Battleford Capital Inc), as at December 31, 2005 and the statement of operations and deficit for the period from incorporation on January 5, 2005, to December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and the results of its operations and cash flows for the period from incorporation on January 5, 2005 to December 31, 2005 in accordance with Canadian generally accepted accounting principles.

"signed" Mackay LLP

Chartered Accountants

Calgary, Canada
April 28, 2006

Sahara Energy Ltd.
(An Exploration Stage Company)

Balance Sheet

As at December 31,		2005
Assets		
Current		
Cash and cash equivalents	$	2,045,244
Accounts receivable – Note 4		136,531
Prepaid expenses		15,316
		2,197,091
Property, plant and equipment – Note 5		1,843,481
	$	4,040,572
Liabilities		
Current		
Accounts payable and accrued liabilities	$	146,992
Future tax liability – Note 8		135,000
		281,992
Shareholder's Equity		
Share capital – Note 6		3,686,064
Warrants – Note 6		193,010
Contributed surplus – Note 7		237,814
Deficit		(358,308)
		3,758,580
	$	4,040,572

Approved by the Board:

"Peter J. Boswell", Director
Peter J. Boswell

"Ross O. Drysdale", Director
Ross O. Drysdale

Sahara Energy Ltd.
(An Exploration Stage Company)

Statement of Operations and Deficit

Period from January 5 to December 31,		**2005**
Revenue		
Interest	$	10,972
Expenses		
General and administrative (Schedule 1)		128,571
Stock-based compensation		237,814
Depreciation		2,895
		369,280
Net loss representing deficit, end of period	$	(358,308)
Loss per common share - basic and diluted	$	(0.09)
Weighted average number of shares outstanding		3,826,170

Sahara Energy Ltd.
(An Exploration Stage Company)

Statement of Cash Flows

Period from January 5 to December 31,		**2005**
Operating activities		
Net loss	$	(358,308)
Items not affecting cash:		
Depreciation		2,895
Stock-based compensation		237,814
		(117,599)
Changes in non-cash working capital		
Accounts receivable		(136,531)
Prepaid expenses		(15,316)
Accounts payable and accrued liabilities		65,368
		(204,078)
Financing activities		
Issuance of share capital and warrants		3,895,500
Share issue costs		(266,425)
		3,629,075
Investing activities		
Purchase of resource properties		(1,282,650)
Acquisition of property in qualifying transaction		(178,726)
Accounts payable for capital expenditures		81,623
		(1,379,753)
Increase in cash representing cash, end of year	$	2,045,244

Supplemental cash flow information

Broker warrants issued for share issue costs	$	17,694
Shares issued for property acquisition		250,000

1. Incorporation and nature of business

Battleford Capital Inc. ("the Company") was incorporated under the Business Corporations Act (Alberta) on January 5, 2005 and was classified as a Capital Pool Company as defined in Policy 2.4 pf the TSX Venture Exchange ("the Exchange"). The purpose of the Company was to identify and evaluate potential acquisitions or businesses, and once identified and evaluated, to negotiate an acquisition or participation subject to receipt of regulatory and shareholder approval. The Company acquired Captain Energy Inc. ("Captain") as its Qualifying Transaction on November 18, 2005 (see note 3). Subsequent to the acquisition, Battleford and Captain amalgamated and changed the name of the amalgamated company to Sahara Energy Ltd. and continues business under that name.

2. Significant accounting policies

a) Measurement uncertainty

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts and presentation of assets, liabilities, revenues, expenses and disclosures of contingencies and commitments. Such estimates primarily relate to unsettled transactions and events at the balance sheet date which are based on information available to management at each financial statement date.

By their nature, these estimates are subject to measurement uncertainty and the effect of changes in such estimates on the financial statements for current and future periods could be significant.

b) Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income taxes reflect the tax consequences of temporary differences between the balance sheet carrying amounts and their corresponding tax bases. Future income taxes are calculated using the tax rates and laws that are expected to apply when these temporary differences are reflected in taxable income. No recognition is made for future tax assets unless it is more likely than not that the Company would obtain future profitable operations.

c) Financial instruments

The fair value of financial instruments is determined by reference to various market data and other valuation techniques as appropriate. The Company's financial instruments consist of cash and cash equivalents, and accounts payable. The fair value of financial instruments is not estimated by management to be materially different from the carrying value.

d) Joint operations

All oil and gas exploration and development activities are conducted jointly with others and accordingly, the Company only reflects its proportionate interest in such activities.

2. Significant accounting policies - continued

e) Flow-through shares

Resource expenditures deductions for income tax purposes that arise from exploration and development activities and which have been funded by flow-through share arrangements, are renounced to investors in accordance with income tax legislation. On the date that the Company files the renunciation with the tax authorities, a future income tax liability is recorded and share capital is reduced by the estimated tax benefits transferred to shareholders.

f) Other property, plant and equipment

The Company amortizes other property, plant and equipment on the declining balance method at the following rates:

Office furniture and equipment	20%
Computer equipment	30%

The rates are reduced by one-half in the year of acquisition.

g) Stock-based compensation

The Company uses the fair value method of accounting for options granted to employees and consultants. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model and charged to earnings over the vesting period with a corresponding increase in contributed surplus. Upon the exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

h) Earnings per share

Basic earnings per share are calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated based on the treasury stock method, which assumes that any proceeds obtained on the exercise of options or warrants would be used to purchase common shares at the average price during the period.

i) Asset retirement obligation

The fair values of asset retirement obligations are recorded as liabilities on a discounted basis when they are incurred, which is typically when the related assets are acquired, installed, drilled or completed. Amounts recorded for the related assets are increased by the amount of these obligations. Over time the liabilities will be accreted for the change in their present value and the initial capitalized costs will be depleted and amortized over the useful lives of the related assets.

2. Significant accounting policies - continued

j) Cash and cash equivalents

Cash and cash equivalents consist of amounts on deposit with banks and investments in short-term deposits with original maturities of less than three months.

k) Oil and gas properties

The company follows the full-cost method of accounting for oil and gas properties, whereby all costs associated with the exploration for, and development of oil and natural gas reserves, whether productive or unproductive, are capitalized. Costs capitalized include land acquisitions costs, geological and geophysical expenditures, carrying charges on undeveloped properties and drilling and overhead expenses related to exploitation and development of both productive and non-productive wells.

Impairment is recognized if the carrying amount of the property, plant and equipment (PP&E) exceeds the sum of the undiscounted cash flows expected to result from proved reserves. Cash flows are calculated based on an estimate of future prices. In circumstances of impairment, the impairment would be calculated as the amount by which carrying amounts of the PP&E exceed the net present value of future cash flows from proved plus risked probable reserves. The risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying value above the net present value of the Company's future cash flows would be recorded as a permanent impairment. The cost of unproved properties and major development projects are excluded from the ceiling test calculation and subject to a separate impairment test. In circumstances of impairment, the impairment would be calculated as the amount by which carrying amounts of the PP&E exceed the net present value of future cash flows.

Operating costs, net of revenues in relation to activities that are considered to be in the development stage, are capitalized. Judgment is required to determine whether operations are in the development stage. The factors considered include, whether commercially viable production levels have been achieved, whether the well is producing a saleable product, whether the well is operating at predetermined operating levels in relation to commercial operations or other factors as circumstances warrant. Once the operations are no longer considered development stage, revenue is recognized and operating costs are recorded in earnings during the year.

Proceeds from disposition are credited to the net book values of the property and equipment. Gains and losses are not recognized upon disposition of oil and gas properties, unless the disposition would significantly alter the rate of depletion.

Costs capitalized are depleted using the unit-of-production method based on estimated gross proved oil and gas reserves before royalties. To date, no depletion has been recorded as the Company is still in the exploration stage and commercial operations have not commenced.

3. Qualifying transaction

The Company completed its qualifying transaction by acquiring 100% of the issued and outstanding shares of Captain Energy on November 18, 2005. The Company is considered to be the purchaser as it will have the majority of the shares after the amalgamation.

This is a related party transaction as a significant shareholder of Captain is also a shareholder of Battleford. However, the transaction has been recorded as a purchase of Captain at fair values due to an independent valuation of Captain's assets and a substantive change in ownership.

The following table sets out the fair value of the net assets acquired and incorporated into the Company:

		2005
Net assets acquired		
Property and equipment	$	563,726
Future income tax liability		(135,000)
	$	428,726
Consideration		
500,000 common shares	$	250,000
Cash		178,726
	$	428,726

4. Accounts receivable

Accounts receivable consists of the following:

		2005
Joint venture receivable for capital expenditures	$	121,677
GST receivable		14,854
	$	136,531

5. Property and equipment

	Cost	Accumulated Amortization	Net Book Value
Oil and gas properties	$ 1,819,761	$ -	$ 1,819,761
Furniture and equipment	26,615	2,895	23,720
	$ 1,846,376	$ 2,895	$ 1,843,481

The Company is still in the exploration stage of production and as such has not yet determined whether the interest held in the properties at year end has any economic levels of reserves. As such, no depletion has been taken on the property as at December 31, 2005. Incidental net operating costs of $2,000 have been capitalized as of December 31, 2005.

6. Share capital

Authorized:
Unlimited number of:
Common voting shares
Preferred non-voting shares

Issued:

	Shares	Amount
Common shares		
On incorporation	1,900,000	$ 237,500
Initial public offering	2,000,000	500,000
Business acquisition	500,000	250,000
Private placement of flow-through shares	6,116,000	3,058,000
Value assigned to warrants	-	(181,243)
Exercise of options	100,000	25,000
Exercise of warrants	100,000	80,927
Share issue costs – initial public offering	-	(108,621)
Share issue costs – private placement	-	(175,499)
	10,716,000	$ 3,686,064

	Shares	Amount
Warrants		
Broker warrants on initial public offering	200,000	$ 17,694
Flow-through share warrants on issue of flow-through shares	3,058,000	181,243
Exercise of warrants	(100,000)	(5,927)
	3,158,000	$ 193,010

6. Share capital - continued

The Company has assigned values to warrants issued as compensation to brokers as part of the initial public offering. The Company has also assigned values to the flow-through share purchase warrants issued with the private placement of flow-through shares. The values assigned to the warrants were determined by using the Black-Scholes option pricing model with the following assumptions:

	Flow Through Share Purchase Warrants	Broker Warrants
Volatility rate	87%	69%
Risk-free interest rate	5.0%	5.0%
Dividend yield rate	0.00%	0.00%
Forfeiture rate of	0.00%	0.00%
Weighted average life	0.50 years	1.50 years

As at December 31, 2005, the following warrants were outstanding:

Warrants Outstanding	Warrant Price	Weighted Average Remaining Contractual Life	Number of Warrants Currently Exercisable	Weighted Average Exercisable Price of Warrants Currently Exercisable
200,000	0.25	0.96	200,000	0.25
2,958,000	0.75	0.42	2,958,000	0.75
3,158,000	0.72	0.45	3,158,000	0.72

As at December 31, 2005, the following options were outstanding:

Options Outstanding	Option Price	Weighted Average Remaining Contractual Life	Number of Options Currently Exercisable	Weighted Average Exercisable Price of Options Currently Exercisable
290,000	0.25	0.50	290,000	0.25
1,910,000	0.40	4.92	477,500	0.75
2,200,000	0.38	4.34	767,500	0.56

As at December 31, 2005, there were 1,710,000 shares held in escrow.

7. Contributed surplus

In 2005, the Company recorded compensation expense of $237,814 included in contributed surplus as determined based on the fair value of the stock options at the grant date estimated using the Black-Scholes model with the following assumptions:

	2005
Volatility rate	69-88%
Risk-free interest rate	5.0%
Dividend yield rate	0.00%
Forfeiture rate of	0.00%
Weighted average life	5.00 years

8. Income taxes

Income tax expense

Loss before income taxes	$	(358,308)
Expected recovery at 37.62%		(135,000)
Adjustments for:		
Stock-based compensation		90,000
Valuation allowance		45,000
Income tax expense	$	-

Subject to confirmation by income tax authorities, the Company has the following undeducted tax pools:

Future tax assets		2005
Income tax loss carryforwards – expire 2015	$	182,000
Undepreciated Capital Cost Allowance		95,000
Canadian Exploration Expenditures		1,000,000
Canadian Development Expenditures		60,000
Canadian Oil and Gas Property Expenditures		340,000
Share issue costs		213,000
	$	1,890,000

The exploration expenditures incurred during the year have been renounced in their entirety subsequent to year end with an effective date of December 31, 2005. For accounting purpose, the effect of the renunciation will be recorded the day the forms are filed with the tax authorities. See Note 10.

8. Income taxes - continued

The components of the Company's future income tax liabilities are a result of the origination and reversal of temporary differences and are comprised of the following at the future tax rate of 33.62%:

Future tax asset (liability)		**2005**
Income tax loss carryforwards – expire 2015	$	61,000
Property and equipment relating to qualifying transaction		(135,000)
Share issue costs		72,000
Valuation allowance		(133,000)
Future income tax asset (liability)	$	(135,000)

9. Commitments

During 2005, the Company issued 3,058,000 of flow-through common shares. The Company committed to renounce resource expenditures to the subscribers for income tax purposes by March 31, 2006 and to incur qualifying expenditures of this amount by December 31, 2006. The renunciation of the qualifying resource expenditures to shareholders was filed with the tax authorities in March 2006. The Company anticipates utilizing qualifying resource expenditures of $1,000,000 that were incurred in 2005 and $2,058,000 to be incurred in 2006, in order to satisfy this commitment.

A future tax liability approximating $1,030,000 will be recorded in 2006 with a corresponding reduction in share capital.

10. Subsequent events

1) On February 1, 2006 the Company announced the closing of a private placement of fixed rate 10% Convertible Debentures. The Company issued 1035 convertible debentures at a price of $1,000 per debenture for aggregate gross proceeds of $1,035,000. The debentures are each convertible into one unit at a price of $0.57 per unit. Each unit is comprised of one common share and one common share purchase warrant. Each warrant is exercisable into one common share at a price of $0.57 until December 31, 2007.

3) Subsequent to year-end, the following common shares were issued:

a) 300,000 on exercise of 300,000 options for proceeds of $87,000; and
b) 845,000 on exercise of 845,000 warrants for total proceeds of $633,750.

Sahara Energy Ltd.
(An Exploration Stage Company)

Schedule of General and Administrative Expenses

Period from January 5 to December 31,		2005
Expenses		
Salaries and wages	$	42,957
Office and administration		30,035
License fee		10,000
Professional fees		23,031
Shareholder reporting		22,548
	$	128,571

CORPORATE DIRECTORY

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Board of Directors

Peter J. Boswell (2)
Michael Williamson
Ross O. Drysdale (1)(2)
William H. Petrie Sr. (1)(2)

(1) Member of the Audit and Reserves Committee
(2) Member of the Compensation and Governance Committee

Executive Officers

Peter J. Boswell	President and Chief Executive Officer
Michael Williamson	Vice-President, Operations
Quentin C. Enns	Vice-President, Exploration
Murray S. MacLean, C.A.	Chief Financial Officer
Stacey L. Holliday	Corporate Secretary

Auditors

Mackay LLP
400, 11012 Macleod Trail SE
Calgary, Alberta

Transfer Agent

Olympia Trust Company
Calgary, Alberta

Legal Advisors

Burstall Winger LLP
Calgary, Alberta

Stock Exchange Listing

TSX Venture Exchange
Trading Symbol: SAH

Corporate Information also available at:

www.saharaenergyltd.com
www.sedar.com

Sahara Energy Ltd.

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